Supreme Court, U.S.
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No. 06-

IN THE

Supreme Court of the United States

MORGAN STANLEY CAPITAL GROUP INC.,
Petitioner,

v.

PUBLIC UTILITY DISTRICT NO. 1
OF SNOHOMISH COUNTY WASHINGTON, *et al.*,
and
FEDERAL ENERGY REGULATORY COMMISSION,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the Ninth Circuit erred by failing to abide by this Court's decisions in *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956), and *Federal Power Commission v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956), which preclude the Federal Energy Regulatory Commission from retroactively undoing valid, bilaterally negotiated, arms-length wholesale energy contracts that have, at most, minimal impact on retail rates.

PARTIES TO THE PROCEEDING

Petitioner Morgan Stanley Capital Group Inc. intervened in the court of appeals. Other intervenors included Allegheny Energy Supply Co., LLC, American Electric Power Service Corp., BP Energy Co., Calpine Energy Services, L.P. and Mirant Americas Energy Marketing (now Mirant Energy Trading LLC). El Paso Merchant Energy L.P. also intervened but no longer has an interest in this matter.

Respondent Public Utility District No. 1 of Snohomish County Washington was the petitioner below.

Respondent Federal Energy Regulatory Commission was the respondent below and is respondent here "by rule." *See* Sup. Ct. Rule 12.6.

The court of appeals' decision resolved four other separate petitions for review. The petitioners were Snohomish; Southern California Water Company; the Attorney General, State of Nevada; Nevada Power Company; and Sierra Pacific Power Company. Reliant Energy Services, Inc. intervened in the *Snohomish* matter and Enron Power Marketing Inc. intervened in the *Southern California Water Company* matter; neither company has any current interest in this litigation. The Federal Energy Regulatory Commission was the respondent to all four petitions.

In a related decision issued on the same day, the panel applied the decision here to resolve two additional petitions for review. Petitioners were the California Electric Oversight Board; the California Public Utilities Commission; and the Public Utilities Commission of the State of California. In addition to several of the entities listed above, intervenors included Pacific Gas and Electric Company; Nevada Power Company; Southern California Edison Co.; Department of Water and Power of the City of Los Angeles; Public Service Department of the City of Burbank; Public Service Depart-

ment of the City of Glendale; Water and Power Department of the City of Pasadena; Sempra Energy; Coral Power, L.L.C.; PPM Energy, Inc.; and Dynegy Power Marketing, Inc. The Federal Energy Regulatory Commission was the respondent to both petitions.

CORPORATE DISCLOSURE STATEMENT

Morgan Stanley Capital Group Inc. states that its parent company is Morgan Stanley. Based on Securities and Exchange Commission rules regarding beneficial ownership, State Street Bank & Trust Company, 225 Franklin Street, Boston, Massachusetts 02210, beneficially owns 12.1% of Morgan Stanley's stock (based on a Schedule 13G filed on February 9, 2007 by State Street, acting in various fiduciary capacities).

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PETITION FOR A WRIT OF CERTIORARI

Petitioner seeks a writ of *certiorari* to review the judgment of the United States Court of Appeals for the Ninth Circuit.

DECISION BELOW

The opinion of the United States Court of Appeals for the Ninth Circuit is reported at 471 F.3d 1053 and reprinted in the Appendix to the Petition (App.) at 1a-67a. The decision of the Administrative Law Judge is reported at 101 F.E.R.C. ¶ 63,031 and reprinted at App. 68a-245a. The opinion of the Federal Energy Regulatory Commission is reported at 103 F.E.R.C. ¶ 61,353 and reprinted at App. 246a-313a. A related court of appeals decision is reported at 474 F.3d 587 and reprinted at App. 314a-330a.

JURISDICTION

The judgment of the United States Court of Appeals for the Ninth Circuit was entered on December 19, 2006. No petition for en banc review was filed. On March 8, 2007, Justice Kennedy signed an order extending the time for filing the petition for certiorari to and including May 3, 2007. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS

The relevant statutory provisions are reproduced in the Appendix to the Petition at 331a-343a.

STATEMENT

A. Statutory Background

For many years, the electric utility industry was dominated by "vertically integrated" companies that owned power generation, transmission, and distribution facilities. In *Public Utilities Commission of Rhode Island v. Attleboro Steam & Electric. Co.*, 273 U.S. 83 (1927), this Court ruled that states could not regulate interstate wholesale energy power sales. This created the so-called "*Attleboro* gap," which permitted the holding companies to operate largely without regulation

and resulted in an industry "characterized by self-dealing contracts and bloated rates as well as financial control by a few dominant investors."[1]

To address this problem, in 1935 Congress enacted the Federal Power Act ("FPA" or "Act"), 16 U.S.C. § 791a *et seq.* Section 201 of the Act declares that "the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest." *Id.* § 824. Thus, "federal regulation of . . . the sale of such energy at wholesale in interstate commerce is necessary in the public interest." *Id.* The Federal Power Commission was established and granted exclusive jurisdiction to regulate interstate sales of wholesale electric energy. *Id.*

Sections 205 and 206 of the FPA set forth the statutory standards by which the Federal Energy Regulatory Commission ("FERC" or "Commission") – the successor to the Federal Power Commission – must regulate wholesale energy rates. Section 205 provides that all rates charged by sellers of wholesale energy "shall be just and reasonable" and states that any rate "that is not just and reasonable is hereby declared to be unlawful." *Id.* § 824d(a). Section 206 provides that if FERC determines that a wholesale energy rate is "unjust, unreasonable, unduly discriminatory or preferential, [FERC] shall determine the just and reasonable rate" and "shall fix the same by order." *Id.* § 824e(a).

In two unanimous decisions issued the same day (both per Justice Harlan), this Court long ago set the parameters for FERC's regulation of bilateral contracts setting wholesale electric rates under the FPA. *See United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956), and *Federal Power Comm'n v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956). Although *Mobile* arose under the Natural Gas Act and

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[1] James H. McGrew, *Federal Energy Regulatory Commission* at 127 (ABA 2003).

Sierra under the Federal Power Act, this Court expressly noted that the two energy regulatory schemes were substantively identical for relevant purposes. *See Mobile*, 350 U.S. at 347 ("virtually identical provisions") and *Sierra*, 350 U.S. at 353 (relevant provisions "in all material respects substantially identical").

As we explain further below, the landmark *Mobile* and *Sierra* decisions established three core tenets of federal energy law: (1) standard contract principles apply to wholesale energy contracts; (2) the integrity of long term contracts is critical to the energy industry; and (3) FERC may disturb a valid wholesale energy contract only in the rare instance when the contract is causing extensive damage to the public interest.[2] "The *Mobile-Sierra* doctrine has hung over the electric power and natural gas industries since 1956, and the two cases are probably among the dozen best-known public utility decisions by the Supreme Court this century." *Boston Edison Co. v. FERC*, 233 F.3d 60, 66 (1st Cir. 2000). *See generally California v. FERC*, 495 U.S. 490, 499 (1990) (recognizing the respect this Court "must accord to longstanding and well-entrenched decisions, especially those interpreting statutes that underlie complex regulatory regimes").

B. Facts

The contract dispute here centers on an agreement between petitioner Morgan Stanley Capital Group Inc. ("Morgan Stanley") and respondent Public Utility District No. 1 of Snohomish County ("Snohomish"). Morgan Stanley is a "power marketer" – *i.e.*, it has regulatory approval from FERC to sell

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[2] As used in this petition, a "valid" contract refers to a contract that conforms with the ordinary rules of contract law. Obviously, even a valid contract is subject to FERC's regulatory authority under the FPA.

wholesale electricity at market-based rates.[3] Snohomish is a public utility in Washington.

In December 2000, Snohomish issued a Request for Proposals inviting seventeen entities to submit bids to supply wholesale energy. App. 162a. Around this time, California and other Western regions of the United States were experiencing a severe energy shortage. In particular, prices in Washington for energy to be delivered within 24 hours – referred to as "spot" energy – were very high by historical standards. Although spot market prices have historically averaged $24 per Megawatt Hour ("MWh") in this area, during this period spot prices peaked at $3,300/MWh. App. 25a. In the midst of this period of high prices and extreme volatility, Snohomish sought to limit its exposure to high spot prices by seeking to enter long term agreements. Sellers of power under long term contracts bear the risk of any subsequent price increases above the contract price during the term of the contract.

In mid-January 2001, Morgan Stanley and Snohomish signed a wholesale energy agreement. Over the course of a week, Morgan Stanley and Snohomish engaged in extensive and detailed negotiations that included numerous conference calls and the exchange of multiple draft contracts. App. 162a-165a. Snohomish repeatedly "demanded" that Morgan Stanley revise the price, quantity and duration of its power supply offer to meet the price terms Snohomish sought to achieve. App. 162a. Morgan Stanley's first proposal was "for power for periods of one, two or three years with gradually decreasing

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[3] In 1994, Morgan Stanley applied to the Commission for authority to sell electricity at market-based rates. Finding no evidence of market power in generation and transmission, no ability to erect other barriers to entry, and no evidence of affiliate abuse or reciprocal dealing, the Commission approved the application. *Morgan Stanley Capital Group, Inc.*, 69 F.E.R.C. ¶ 61,175 (Nov. 8, 1994). The Commission has repeatedly granted Morgan Stanley market-based rate authority. *See, e.g., Morgan Stanley Capital Group, Inc.*, No. ER94-1384-029 (June 26, 2001).

prices respectively." App. 163a. "Snohomish rejected this bid," and "specifically requested Morgan Stanley to bid 'for however many months' to permit Snohomish to purchase power for approximately $110/MWh." App. 163a-164a. Snohomish subsequently "informed Morgan Stanley that a price 'slightly over' $100/MWh, might be acceptable." App. 164a. "Morgan Stanley complied with Snohomish's request" and agreed to sell Snohomish 25 MWhs of "round-the-clock" energy at a price of $105/MWh for a period of 105 months (8.75 years). App. 164a.

The agreement between Morgan Stanley and Snohomish incorporated the Western Systems Power Pool Agreement, which only permits "joint [*i.e.*, not unilateral] application to FERC for a change in the rates and charges . . . ." App. 42a. In addition, the agreement contains a specific provision stating that neither party can seek to change the agreement by invoking Section 206 of the FPA (as Snohomish has now attempted to do). The agreement states: "The rates for service specified in this Agreement shall remain in effect for the term of this Agreement and *shall not be subject to change* through application to FERC pursuant to the provisions of Section 205 or 206 of the Federal Power Act." App. 194a (emphasis added).

After Snohomish entered into a binding long term agreement to purchase power from Morgan Stanley, Snohomish started reselling this power at a significant profit in the spot market. In the first five months of 2001, Snohomish made over $17 million by selling this power on the spot market. App. 218a.

C. FERC's Decision

After the energy shortage had eased and energy prices dropped accordingly, respondent Snohomish filed a complaint under Section 206(a) of the FPA asking FERC to void its contract with petitioner Morgan Stanley. Petitioner Morgan Stanley intervened.

In an Order setting the complaint for an evidentiary hearing, the Commission made clear that it could only undo this contract if it found the circumstances exceptional. FERC explained:

> The Commission's long-standing policy, consistent with a substantial body of Supreme Court and other judicial precedent, has been to recognize the sanctity of contracts. Rarely has the Commission deviated from that policy, and then only in extreme circumstances, such as the fundamental industry wide restructuring under Order No. 888 and the reorganization of a bankrupt utility.[4] *Preservation of contracts has, if anything, become even more critical since the policy was first adopted.* Competitive power markets simply cannot attract the capital needed to build adequate generating infrastructure without regulatory certainty, including certainty that the Commission will not modify market-based contracts unless there are *extraordinary* circumstances.

App. 147a-48a (first emphasis added).

The Snohomish complaint was adjudicated in a consolidated hearing before an Administrative Law Judge ("ALJ").[5] The ALJ relied on the *Mobile-Sierra* doctrine in ruling that FERC could not and should not disturb the contract between Morgan Stanley and Snohomish. App. 245a. After quoting the

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[4] In 1996, FERC issued Order 888 requiring that any utility operating transmission lines must allow any other utility in the interstate energy market to use its transmission lines on the same terms applicable to the operating utility itself. *See New York v. FERC*, 535 U.S. 1 (2002).

[5] The hearing also included complaints filed by Nevada Power and Sierra Pacific (together the "Nevada Companies") and Southern California Water Company against certain sellers.

Commission's Order regarding the importance of contract stability, App. 147a-48a, the ALJ summarized her exhaustive opinion as follows: "The record demonstrates that the contract prices were consistent with market prices at the time each contract was executed. The record also shows that these transactions were bona fide arm's-length transactions between knowledgeable companies. In the past, the Commission has enforced the parties' bargains in similar circumstances. Accordingly, it is found that [Snohomish and other complainants] failed to meet their burden of proof. . . ." App. 219a-20a.

The Commission affirmed the ALJ's decision, ruling that it could not and should not undo this contract. App. 313a. "At the time of contract execution," the Commission found, "other alternatives were available" to Snohomish but it "chose to enter into the contracts in question, accepting market risks." App. 252a. Snohomish "benefited from resales of the energy purchased under these contracts during the relevant period," yet "after the drop in prices in mid-2001" it "became dissatisfied with [its] bargain[] and sought contract modification." App. 252a. Reviewing the Western Area Power Pool Agreement, the Commission found that the parties had intended to foreclose unilateral contract modification. App. 259a. FERC emphasized that the "fact that a contract becomes uneconomic over time does not render" the contract rate unlawful. App. 252a. Nor did Snohomish demonstrate that its binding agreements with Morgan Stanley threatened extraordinary damage to the public interest. Snohomish "failed to demonstrate that the contract[] in question caused financial distress for [Snohomish] so as to threaten [its] ability to continue service, that the contract[] [was] unduly discriminatory to the detriment of other customers that are not parties to this proceeding, or that any other factor on this record demonstrate that the contract[] [is] contrary to the public interest." App. 252a.

D. Ninth Circuit's Decision

Snohomish filed a petition for review with the Court of Appeals for the Ninth Circuit.

In the Ninth Circuit, FERC argued that it could not and should not disturb the contract between Morgan Stanley and Snohomish. Quoting from its Order, FERC again emphasized:

> 'The Commission's long-standing policy, consistent with a substantial body of Supreme Court and other judicial precedent, has been to recognize the sanctity of contracts.' Further, '[p]reservation of contracts has, if anything, become even more critical since the policy was first adopted. Competitive power markets simply cannot attract the capital needed to build adequate generating infrastructure without regulatory certainty, including certainty that the Commission will not modify market-based contracts unless there are *extraordinary* circumstances.'

FERC Ct. App. Br., No. 03-74208, 2004 WL 2682046, at *9 (filed Sept. 23, 2004) (alterations and emphasis in original; citations omitted). The agency detailed at length how the Morgan Stanley – Snohomish contract was not remotely, let alone unduly, damaging to the public interest. *Id.* at *114-33. Indeed, "the contract arguably resulted in rate relief." *Id.* at *116. The agency also invoked principles of judicial deference to agency determinations. *Id.* at *58, *61.

Nevertheless, the Ninth Circuit (Browning, Pregerson, Berzon, J.J.) ruled that FERC's (clearly correct) decision not to disturb the long term contract between petitioner and respondent was unlawful. App. 3a-4a, 65a-67a. Reviewing the Western Area Power Pool Agreement, the panel acknowledged that the parties intended to foreclose unilateral contract modification. App. 42a. The court then asserted, however, that the

Mobile and *Sierra* presumption of contract stability applies only in "certain limited circumstances." App. 36a; *see also* App. 7a (*Mobile* and *Sierra* applicable "*in certain circumstances*") (emphasis in original). Observing that "no case has outlined these conditions succinctly," App. 37a, the panel announced several rationales for disregarding *Mobile* and *Sierra*.

The panel's principal justifications for disregarding *Mobile* and *Sierra* amount to purported distinctions between the circumstances there and the circumstances here. The Ninth Circuit held that the past decades' changes in regulation of the power markets have rendered *Mobile* and *Sierra* obsolete if not yet a "dead letter." App. 10a-11a. Similarly, the Ninth Circuit held that *Mobile* and *Sierra* do not apply to this wholesale energy contract because it was entered into under FERC's modern market-rate approval scheme. App. 42a. The Ninth Circuit also held that *Mobile* and *Sierra* do not apply because the original contract negotiations did not occur in a "functional marketplace," even though the Ninth Circuit never disputed FERC's view "that the spot and forward markets can and should be analyzed separately" nor FERC's conclusion that "there is nothing in the record" to support a finding of "market manipulation *specific to* the long-term contract[] at issue here." App. 301a (emphasis in original).

The Ninth Circuit's last effort to marginalize *Mobile* and *Sierra* is a purported "modification" of the "public interest" standard that permits FERC to invalidate this contract even under *Mobile* and *Sierra*. App. 63a-64a. After holding the *Mobile* and *Sierra* presumption that contracted rates are just and reasonable rates inapplicable here, the Ninth Circuit went on to hold that in any event FERC could find that circumstances warrant invalidating this valid contract. The panel expressly rejected this Court's "excessive burden" standard as inapplicable to this "high rate" case. App. 63a-64a. In the Ninth Circuit's view, the enforceability of the parties' bargain should be analyzed under different standards depending upon whether prices have moved against the buyer – a "high rate"

case (where prices decline post contract formation) – or the seller – a "low rate" case (where prices increase). "[A] high-rate public interest determination should focus on whether consumers' electricity bills have been affected by the challenged rates." App. 64a. The panel found that FERC did not properly assess whether the contracts at issue here violated this watered-down understanding of the "public interest," a test that should require a showing that the agreement is causing extraordinary damage to the public interest. App. 65a. In the panel's view, FERC could invalidate the contract because "FERC specifically found that the challenged Morgan Stanley contract accounted for an eight percent increase for retail ratepayers over 2001 rates." App. 65a.[6]

The panel remanded the matter to FERC. The Ninth Circuit instructed FERC to "apply the proper statutory standards to determine, first, whether *Mobile-Sierra* review of the challenged contracts is appropriate; second, if so, to apply the modified form of *Mobile-Sierra* review outlined in this opinion; and finally, if not, to apply full just and reasonable review to the challenged contracts." App. 66a-67a.

REASONS FOR GRANTING THE PETITION

The Ninth Circuit's decision announcing a "modified form of *Mobile-Sierra* review" is in fact a repudiation of those landmark rulings. For more than half a century, the power industry has operated on the bedrock assumption that when two commercial parties negotiate a valid arms-length contract, the agreed upon terms at which sophisticated buyers were willing to buy and sophisticated sellers to sell should not be set aside after-the-fact by FERC or, as here, appellate judges. Rather, this Court's long-standing precedent allows FERC to undo a

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[6] The panel also noted that "Snohomish claims that it suffered losses between January 2001 and March 2002 in excess of $25.7 million and that those losses will escalate over the term of the contract as market rates remain close to traditional levels." App. 27a.

wholesale energy contract only in the extraordinary circumstances where a contract is causing extensive damage to the public interest. Appropriately, throughout this case FERC has insisted that the precedents of this Court "recognize the sanctity of contracts" and require FERC to uphold this contract. By overriding the parties' valid contract and confining the *Mobile-Sierra* doctrine to "certain limited circumstances," the Ninth Circuit has eviscerated core precedents from this Court even though those precedents have, until now, played a fundamental role in securing expectations of contract stability in the wholesale energy market. The panel's "modification" of the *Mobile-Sierra* doctrine to permit FERC to undo this contract is not a tenable reading of those cases and creates a conflict with other courts of appeals.

The result of the Ninth Circuit's marginalization of *Mobile* and *Sierra* is a dramatic expansion of the circumstances under which FERC – at the invitation of parties unhappy with a change in market conditions – will second-guess the terms of valid contracts. In overlooking *Mobile* and *Sierra's* recognition that the energy industry has a unique and critical need for long term contract stability, the panel's decision will necessarily reduce overall long term investment in the energy industry. In excluding *Mobile* and *Sierra* where FERC has relied upon negotiation between sophisticated parties with a demonstrated lack of market power to produce wholesale rates that it will not disturb absent extraordinary circumstances, the panel has called into question FERC's decades-long effort to craft a modern energy regulatory regime. And, dangerously, the panel's decision to ignore the *Mobile* and *Sierra* insight that ordinary contract law principles apply to the wholesale energy market imposes regulatory obstacles that will hinder the energy market from responding effectively to the next energy crisis. This Court's immediate review is warranted.

I. THE *MOBILE-SIERRA* DOCTRINE FORBIDS FERC FROM MODIFYING A VALID WHOLESALE ENERGY CONTRACT UNLESS THE CONTRACT IS CAUSING EXTRAORDINARY DAMAGE TO THE PUBLIC INTEREST

For over fifty years, this Court has insisted that federal regulation of wholesale energy contracts respect market forces. This Court's landmark *Mobile* and *Sierra* decisions held that FERC's original understanding of the FPA underemphasized the importance of contract principles in the wholesale energy market. 350 U.S. at 338; 350 U.S. at 355. Since then, citing a "substantial body of Supreme Court" precedent, FERC has repeatedly emphasized the importance of upholding a valid wholesale energy contract unless the contract is causing extraordinary damage to the public.

In particular, *Mobile* and *Sierra* made clear the basic legal tenets governing wholesale energy contracts. *Mobile* emphasizes that the Natural Gas Act "expressly recognizes that rates to particular customers may be set by individual contracts." 350 U.S. at 338. Thus, in "construing the Act, [the Court] should bear in mind that it evinces no purpose to abrogate private rate contracts." *Id.* Indeed, "all rates are established initially by the [power] companies, by contract or otherwise." *Id.* at 341. Of course, under the Commission's "basic power" of Section 206 "all rates are subject to being modified by the Commission upon a finding that they are unlawful." *Id.* at 341. But, *Mobile* emphasizes, the Commission's authority to modify rates is "neither a 'rate-making' nor a 'rate-changing' procedure.'" *Id.* Thus, "the initial rate-making and rate-changing powers of natural gas companies remain undefined and unaffected by the Act." *Id.* at 343. Energy companies may decide "to fix by contract, and change only by mutual agreement, the rate agreed upon with a particular customer." *Id.* In such circumstances, "there is nothing in the structure or purpose of the Act from which" the Court could "infer the right, not otherwise possessed and nowhere expressly given in

the Act, of natural gas companies unilaterally to change their contracts." *Id.* at 343-44.

In holding that an energy company cannot unilaterally change wholesale energy rates set by contract, *Mobile* overruled FERC's then-view of the FPA and Natural Gas Act. FERC had argued that filing a new rate with FERC automatically rendered the new rate valid under the "'filed-rate' procedure" of the Natural Gas Act. 350 U.S. at 337, 340. The Court found that this argument was "based on a misconception of the structure of the Act." *Id.* at 341. The filed-rate section "say[s] only that a change cannot be made without the proper notice to the Commission; it does not say under what circumstances a change can be made." *Id.* at 339. "To find" in that provision "a further purpose to empower natural gas companies to change their contracts unilaterally requires reading into it language that is neither there nor reasonably to be implied." *Id.* at 340.

Mobile also emphasized that enforcement of "long-term" contracts is critical to the energy industry. *Id.* at 333. "By preserving the integrity of contracts," the Court explained that its decision "permits the stability of supply arrangements which all agree is essential to the health of the natural gas industry." *Id.* at 344. Energy facilities "may frequently require substantial investments which the consumer would be unwilling to make without long-term commitments from the distributor, and the distributor can hardly make such commitments if its supply contracts are subject to unilateral change by the natural gas purchaser whenever its interests so dictate." *Id.*

Sierra sets out the parameters of FERC's role in regulating wholesale energy rates set by contract.[7] *Sierra* resolved "a further question not present in the *Mobile* case": whether, under Section 206, FERC can declare a contract "either 'unjust' or 'unreasonable' simply because it is unprofitable to the public utility." 350 U.S. at 355. FERC had found the contracted rates "unreasonably low and therefore unlawful," and on that ground permitted the public utility to change the rate paid to the power distributor. *Id.* at 354 (quotation marks omitted). This Court, however, again found that FERC improperly had minimized the importance of contract stability. The Court explained that while "the Commission may not normally impose upon a public utility a rate which would produce less than a fair return, it does not follow that the public utility may not itself agree by contract to a rate affording less than a fair return or that, if it does so, it is entitled to be relieved of its improvident bargain." *Id.* at 355. The Court held that the purpose of the Commission's authority under Section 206(a) "is the protection of the public interest, as distinguished from the private interests of the utilities," and that, as a result, "it is clear that a contract may not be said to be either 'unjust' or 'unreasonable' simply because it is unprofitable to the public utility." *Id.*

In the course of holding that FERC may not void a wholesale energy contract based on a utility's after-the-fact unhappi-

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[7] *Mobile* noted that denying energy companies "the power unilaterally to change their contracts in no way impairs the regulatory powers of the Commission, for the contracts remain fully subject to the paramount power of the Commission to modify them when necessary in the public interest." 350 U.S. at 344. Although *Mobile* did not further address when FERC could cut short a long term contract "when necessary in the public interest," the *Mobile* Court affirmed the lower court's holding that the rate could not be changed "merely because the [economic] return is low." *Mobile Gas Serv. Corp. v. Fed. Power Comm'n*, 215 F.2d 883, 889 (3d Cir. 1954) ("there seems no doubt but that the [] account represented important new business to Mobile and to United and that the long range concession was made in order to obtain it").

ness with an agreement, *Sierra* described the limited criteria by which FERC may invalidate a wholesale energy contract. Pointing to Section 201(a)'s declaration that energy regulation "is necessary in the public interest," the Court announced the following, oft-quoted, description of when the Commission may invalidate a valid long term wholesale energy contract:

> In such circumstances, the sole concern of the Commission would seem to be whether the rate is so low as to adversely affect the public interest – as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory.

Id. In short, only if a contract would cause extraordinary damage to the public – akin to the closing of a public utility – can FERC void a valid energy contract.

II. THE NINTH CIRCUIT'S DECISION IS IN DIRECT CONFLICT WITH *MOBILE* AND *SIERRA*

The Ninth Circuit panel offered three reasons for requiring that FERC re-examine its decision – a correct decision expressly based on this Court's *Mobile-Sierra* doctrine – not to undo the contract between petitioner and respondent. Each reason highlights the direct conflict between the decision below and the landmark *Mobile* and *Sierra* decisions.

1. The Ninth Circuit's opinion begins by placing *Mobile* and *Sierra* in the historical dustbin. In the panel's view, changes to energy regulation in the past decades have rendered *Mobile* and *Sierra* largely obsolete. *See* App. 11a-22a. In a similar misuse of history, the Ninth Circuit holds that *Mobile* and *Sierra* do not apply to wholesale energy rates approved under FERC's modern, market-based approval scheme. App. 39a (in "*Mobile* and *Sierra* the rates had been submitted to the agency previously under section 205 and allowed to remain in

effect"). But this Court, FERC, and numerous courts of appeals have expressly recognized that the respect for integrity of wholesale energy contracts announced by *Mobile* and *Sierra* is as vital today as it was more than fifty years ago.

At the outset, nothing confirms the current vitality of *Mobile* and *Sierra* better than the fact that petitioner and respondent expressly entered into a contract that made these decisions applicable: "The rates for service specified in this Agreement shall remain in effect for the term of this Agreement and *shall not be subject to change* through application to FERC pursuant to the provisions of Section 205 or 206 of the Federal Power Act." App. 194a (emphasis added). The panel agreed that this contract was intended to bind the parties under *Mobile* and *Sierra*. App. 42a.

Consistent with the parties' expectations, this Court's recent decision in *Verizon Communications Inc. v. FCC*, 535 U.S. 467, 476 (2002), teaches that *Mobile* and *Sierra* should continue to guide lower courts' consideration of wholesale energy rate regulation. In *Verizon*, the Court noted that in the FPA and the Natural Gas Act Congress "acknowledged that contracts between commercial buyers and sellers could be used in ratesetting." 535 U.S. at 479 (citing *Mobile* and *Sierra*). "In wholesale markets," the Court explained, "the party charging the rate and the party charged were often sophisticated businesses enjoying presumptively equal bargaining power, who could be expected to negotiate a 'just and reasonable' rate as between the two of them." *Id.* "When commercial parties did avail themselves of rate agreements," the Court continued, "the principal regulatory responsibility was not to relieve a contracting party of an unreasonable rate, but to protect against potential discrimination by favorable contract rates between allied businesses." *Id.* The *Verizon* opinion quotes at length *Sierra*'s holding that FERC may not undo a wholesale energy contract merely because of an "improvident bargain." *See id.* at 479-80.

The Ninth Circuit's effort to limit *Mobile* and *Sierra* to instances where FERC reviews specific contracts not only misreads the relevant facts, it ignores the core rationale of the *Mobile* and *Sierra* rulings. As *Verizon* explains, *Mobile* and *Sierra* hold that "sophisticated businesses enjoying presumptively equal bargaining power" are "expected to negotiate a 'just and reasonable' rate as between the two of them." 535 U.S. at 479. That reasoning does not depend on whether the "sophisticated business" was required to make a regulatory filing. The *Mobile* and *Sierra* emphasis on privately negotiated rates and the need for long term contact stability extends to all wholesale energy contracts.

Moreover, and contrary to the apparent understanding of the Ninth Circuit panel, *Mobile* and *Sierra* did not involve rates that FERC approved by virtue of accepting the higher rates for filing. The law was (and is) clear that FERC's acceptance of rates for filing does not constitute substantive approval of the rates as just and reasonable. FERC's regulations – then and now – expressly state that the "acceptance for filing of any tariff, contract or part thereof does not constitute approval by the Commission." 18 C.F.R. § 154.6 (2006); 18 C.F.R. § 154.23 (1955) (same). The Commission's order in *Mobile* accepting the higher rate for filing is explicit: "Nothing contained in this order shall" "be construed as constituting approval by this Commission of any service, rate, charge, classification . . . in the above designated schedule." Cert. Pet. filed in 1955, Oct. Term, No. 17. For this reason, the *Mobile* decision squarely holds that filing requirements have no bearing on FERC's regulatory authority. 350 U.S. at 338 (Court saw "no basis in the language of [the filing provisions] for inferring that the mere imposition of a filing-and-notice requirement was intended to make effective action which would otherwise be of no effect at all").

To be sure, at the time *Mobile* and *Sierra* were decided, the energy market did not include entities like petitioner Morgan Stanley, a "power marketer" that purchases and sells

wholesale energy that it does not generate and indeed often has no, or very limited, direct or indirect ownership or control of generation assets.[8] But a power marketer by its very nature relies even more on the contract certainty promised by *Mobile* and *Sierra*; its core business is buying and selling contracts. A power marketer cannot operate at all if "its supply contracts are subject to unilateral change by the [power purchaser] whenever its interests so dictate." *Mobile*, 350 U.S. at 344.

For this reason, FERC has repeatedly emphasized the *increased* importance of contract stability in the modern energy markets. In requiring that respondent comply with this valid contract, FERC properly emphasized its "long-standing policy, consistent with a substantial body of Supreme Court precedent" of recognizing "the sanctity of contracts." App. 147a. FERC explained that "[p]reservation of contracts has, if anything, become even more critical since the policy was first adopted." App. 147a.

So too, courts of appeals have often applied the *Mobile-Sierra* doctrine to contracts entered into under the modern regulatory regime. For example, in *Boston Edison Co. v. FERC*, 233 F.3d 60 (1st Cir. 2000), the First Circuit discussed the *Mobile-Sierra* doctrine at length and concluded that FERC could not disturb a valid contract unless the contract was causing extensive damage to the public interest. *See id.* at 64-69. Similarly, in *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667, 710 (D.C. Cir. 2000), *aff'd sub nom., New York v. FERC*, 535 U.S. 1 (2002), the D.C. Circuit found that FERC's orders complied with "the Supreme Court's *Mobile-Sierra* doctrine." Given the modern-day adherence to *Mobile* and *Sierra* by the First and D.C. Circuits, there is little

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[8] Since at least 1989, FERC has encouraged power marketers to enter the energy market and sell power at market prices. *Citizens Power & Light Corp.*, 48 F.E.R.C. ¶ 61,210, 61,776 (1989).

doubt that those courts would, like FERC, have upheld the Morgan Stanley – Snohomish contract.

In sum, the Ninth Circuit's holding that would render *Mobile* and *Sierra* a virtual "dead letter," App. 10a, is in direct conflict with the expectations of the parties, *Verizon*, numerous pronouncements by FERC, and decisions from other courts of appeals, all of which confirm that the *Mobile-Sierra* doctrine remains vital today.

2. The Ninth Circuit's second justification for sidelining *Mobile* and *Sierra* is to emphasize the "market dysfunction" in 2000-2001 spot energy prices. In the panel's view, unlawful price manipulation in the energy spot market would permit FERC to undo the long term contract between petitioner and respondent, a contract entered into during the spot market crisis, even absent any finding that the contract is causing extraordinary damage to the public interest. App. 3a, 56a. But the fact of high or even manipulated spot energy prices would do nothing to undermine *Mobile*'s point that ordinary contract law principles must apply in the energy industry.

The California spot market energy crisis of 2000-2001, including rolling blackouts and other urgent measures, created emergency conditions in many respects. FERC found that the California spot market had inflated prices possibly due, among other things, to unlawful price manipulation. App. 95a, 292a. FERC has ordered significant refunds to consumers harmed by the spot market manipulation.[9] FERC also conducted separate

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[9] *See* Br. for FERC in Opp'n, *Coral Power, LLC v. California ex rel. Brown*, Nos. 06-888 and 06-1100, at 8-9 (filed Feb. 5, 2007) (noting FERC has "approved or facilitated numerous settlements providing for over $6 billion in refunds for alleged market manipulation or excessive rates in the West during 2000 and 2001").

investigations of alleged misconduct and has reached settlements that provide additional relief for ratepayers.[10]

The high spot market prices in 2000-2001 do nothing to undermine the necessity of enforcing long term agreements entered into at that time. Significantly, FERC found, and the Ninth Circuit does not dispute, "that the spot and forward markets can and should be analyzed separately," App. 59a, and that "there is nothing in the record" to support a finding of "market manipulation *specific to* the long-term contracts at issue here." App. 301a (emphasis added). The ALJ found: "The evidence in this case demonstrates that forward [*i.e.*, non-spot] markets, during the period in question in this proceeding, were competitive and not dysfunctional." App. 121a; *see also* App. 122a ("evidence in this case establishes that the forward market was a well functioning market (functioning competitively and efficiently) during the period in question").

Rather than a rationale for invalidating long term contracts, high spot prices are a sound reason for participants in the energy market to enter into long term agreements. As the ALJ noted, Snohomish "benefited" from the agreement it now seeks to vitiate because "it hedged against fluctuations in the spot market" and thus "protected its ratepayers from additional rate increases." App. 161a. "The record conclusively shows that it was Snohomish's choice to pass the risk of price volatility to the seller [Morgan Stanley] and pay a below market rate of $105 for the first five years, even if the contract had to be for a longer term." App. 164a. In addition, "[t]he evidence demonstrates that, shortly after Snohomish entered in the con-

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[10] *See San Diego Gas & Elec. Co.*, 101 F.E.R.C. ¶ 63,026 (2002); *see also, e.g., San Diego Gas & Elec. Co. v. Sellers of Energy & Ancillary Servs.*, 110 F.E.R.C. ¶ 61,336 (2005). In *California ex. rel. Lockyer v. FERC*, 383 F.3d 1006 (9th Cir. 2004), the Ninth Circuit reversed FERC's determination as to the precise time period in which refunds were available. Petitions for certiorari are pending. *See Coral Power v. FERC*, No. 06-888 and *Brown v. Coral Power*, No. 06-1100.

tract, it touted to its customers that the Morgan Stanley and other long-term contracts 'give us a lot of security against the uncertainty of market fluctuations,' and that the contracts insulate the ratepayers from market volatility." App. 166a. In short, long term agreements are an important mechanism by which participants in the energy market protect themselves against high spot prices

The facts of *Sierra* help illustrate how participants in the energy market protect themselves against the risk of changes in market conditions. In *Sierra*, "increased postwar demands and consumer agitation for cheaper power" led Sierra Pacific Power Company ("Sierra") to negotiate with Pacific Gas and Electric Company ("PG&E") for additional power. 350 U.S. at 352. At the same time, Sierra was "negotiating for power from other sources, including the Federal Bureau of Reclamation, which at the time had unused capacity at Shasta Dam." *Ibid.* "To forestall the potential competition, PG&E offered Sierra a 15-year contract for power at a special low rate, which offer Sierra finally accepted." *Id.* Under this agreement, PG&E earned a 2.6% rate of return, well below PG&E's normal 5.5% rate of return. *Id.* at 353-54. After the "potential competition" diminished, PG&E sought a better rate of return. Specifically, five years after signing the 15 year agreement, "when power from Shasta Dam was no longer available to Sierra, PG&E, without the consent of Sierra" filed with FERC "a schedule purporting to increase its rate to Sierra by approximately 28%." *Id.* at 353. Under the new rate, PG&E would earn a 4.75% rate of return. *Id.* at 354.

Acting under its power to modify rates, FERC would have allowed PG&E to void the contract. 350 U.S. at 354. FERC concluded that the original agreement was "unreasonable" because it provided a rate of return "substantially less than the 4.75% resulting from the proposed rate, which is the minimum PG&E is willing to accept." *Id.* (quotation marks omitted). The *Sierra* Court overruled FERC because PG&E agreed "by contract to a rate affording less than a fair return" and thus

FERC could not relieve the utility of its "improvident bargain." *Id.* at 355.

Here, the change in prices in the spot market, even if in part caused by market manipulation, is not meaningfully different from the change in energy prices caused by the sudden availability of power from the Shasta dam. Like PG&E, respondent Snohomish participated in a competitive negotiation process and agreed to a wholesale energy rate. The negotiations here, just like the negotiations between PG&E and Sierra, took place in unusual market conditions – in *Sierra* new supply caused by the availability of a federal dam and here spot market price spikes caused by a host of factors – that resulted in altered energy prices as compared to historical prices. All of the parties, here respondent and petitioner and there PG&E and Sierra, were well aware of these market conditions. Under the proposed long term agreements, Snohomish's customers would pay a higher retail rate, just like PG&E would earn less profit than in the past. Nevertheless, the parties in this case and in *Sierra* entered into long term wholesale energy rate agreements (9 years here vs. 15 years in *Sierra*). Just like PG&E, respondent Snohomish has sought to invalidate the agreement once the market conditions changed to its detriment; PG&E sought its traditional rate of return while Snohomish claims that it will incur millions of dollars in losses. App. 27a. *Sierra* expressly forbids FERC from undoing valid contracts based solely on claims of economic loss.

To be sure, Snohomish seeks to void a contract purportedly to pass through a lower rate for its retail consumers while PG&E sought to void the contract to earn a higher rate of return. But that factual difference, like the difference in contract length or rate of return, does not affect the fundamental economic identity between respondent's position and PG&E's. Both companies entered into a long term deal when market conditions warranted, and both companies sought to undo the deal when market conditions became less favorable to their position. *Cf. Weyerhaeuser Co. v. Ross-Simmons Hardwood*

Lumber Co., Inc., 127 S. Ct. 1069, 1076 (2007) (applying same legal test to predatory bidding claims and predatory pricing claims because "claims are analytically similar").

Putting this fundamental point more generally, any dysfunction in the spot market was, at most, a fact about the world that both petitioner and respondent were free to take into account when agreeing to their long term contract. This fact about the market is no different from any other market condition. The issue is not whether market conditions affected contracting. Both buyers and sellers were making decisions in response to the same market dynamics. Absent extraordinary damage to the public interest, there is no reason why petitioner should be disadvantaged based on the market characteristics in force at the time of the contracting.

Just as *Mobile* and *Sierra* hold that an unanticipated change in market conditions does not warrant undoing a long term contract absent the contract causing extraordinary damage to the public interest, so too the spot energy market conditions in 2000–2001 do not warrant undoing a long term contract absent such a finding. The Ninth Circuit's holding to the contrary is in direct conflict with *Mobile* and *Sierra*.

3. Although the bulk of the opinion below renders *Mobile* and *Sierra* a virtual "dead letter," the Ninth Circuit also holds that FERC can undo this contract consistent with the *Mobile-Sierra* doctrine. App. 10a-11a. Under the Ninth Circuit's new version of the doctrine, FERC can invalidate almost any contract. *Mobile* and *Sierra* prohibit that result.

The ease with which FERC can disturb contracts under the Ninth Circuit's "modification" of *Mobile* and *Sierra* is demonstrated by the contract at issue here. Although FERC explained to the panel that this contract "arguably resulted in rate relief," the panel emphasized that "FERC specifically found that the challenged Morgan Stanley contract accounted for an eight percent increase for retail ratepayers over 2001 rates." App. 27a. But even an 8% increase of retail rates is

nothing like the economic hardship that would require, for example, a power utility to close down (*Sierra*). If a single-digit impact on retail rates permits FERC to undo a valid wholesale energy contract, then FERC has carte blanche under this substantially "modified," App. 30a-31a, public interest test to undo almost any energy contract. *Mobile* and *Sierra* reject this expansive view of FERC's role in the wholesale energy market.

Moreover, on this point the Ninth Circuit's opinion is not only contrary to *Mobile* and *Sierra*, it also creates a square conflict with the First and D.C. Circuits. In the Ninth Circuit's view, the enforceability of the parties' bargain should be analyzed under different standards depending upon whether prices have moved against the buyer – a "high rate" case (where prices decline post contract formation) – or the seller – a "low rate" case (where prices increase). App. 62a-63a. But the First and D.C. Circuits have found that FERC has no greater license to modify a long term contract on the basis of rates being too high than it does on the basis of rates being too low. *See Boston Edison*, 233 F.3d at 65 (vacating an order reducing a seller's rate where "FERC never found that the higher rates ... were contrary to the public interest."); *Potomac Elec. Power Co. v. FERC*, 210 F.3d 403, 409 (D.C. Cir. 2000) (affirming FERC's refusal to disturb a long term contract given the complainant's "failure to provide any evidence of undue discrimination or excessive burden, other than the disparity in rates and a bald claim that [the complainant's] ratepayers would derive benefit from a rate modification"). Only the Ninth Circuit applies a one-way ratchet, in which purchasers but not sellers effectively get to change rates at will.

At bottom, the Ninth Circuit's "modification" of the *Mobile-Sierra* public interest test does not modify the test so much as gut the *Mobile-Sierra* doctrine. As explained by this Court and applied by other circuits, the public interest test is a rarely-used mechanism by which FERC can assure that a valid contract does not unduly harm the public in some extraordi-

nary way. But under the decision below, what should be an escape hatch becomes the front door, whereby FERC can use the "public interest" test to invalidate almost any contract with even a modest impact on retail rates. The conflict with *Mobile* and *Sierra* is once again direct.

III. THE DECISION OF THE NINTH CIRCUIT REQUIRES IMMEDIATE REVIEW BECAUSE IT IS SEVERELY DISRUPTING THE NATIONAL ENERGY MARKETS

The decision below is causing and will continue to cause severe damage to the wholesale energy markets.

Most obviously, the decision below undermines long term contract stability in an industry that this Court recognizes is uniquely dependent on it. As the *Mobile* Court explained, energy facilities "may frequently require substantial investments" which will not be made "without long-term commitments" that "can hardly" be made if "supply contracts are subject to unilateral change by the [power purchaser] whenever its interests so dictate." 350 U.S. at 344.[11] The electric energy market is one of the most capital intensive sectors of our economy, with more than $46.5 billion in 2005 capital expenditures.[12] By vastly increasing the risk that a long term energy contract will be undone by FERC, the decision below will lead to decreased investment in energy supply.

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[11] The D.C. Circuit said much the same thing in *DC San Diego Gas & Elec. Co. v. FERC*, 904 F.2d 727, 730 (1990): "The certainty and stability which stems from contract performance and enforcement is essential to an orderly bulk power market. If the integrity of contracts is undermined, business would be transacted without legally enforceable assurances and we believe that the market, the industry and ultimately the consumer will suffer."

[12] *See* Edison Electric Institute, *Key Facts about the Electric Power Industry* ("*Key Facts*") at 47, *available at* http://www.eei.org/industry_issues/industry_overview_and_statistics/nonav_key_facts/KeyFacts_Web.pdf.

In addition, the Ninth Circuit's decision calls into question the settled expectations of the entire energy industry. For decades, FERC has regulated wholesale power markets through market-based rate regulation, a regulatory scheme on which petitioner and others have relied in making significant investments in the energy market. FERC's "market-based rate authority" regime is designed to encourage new energy supplies from power marketers and others. Under this regulatory regime, a seller may obtain "market-based rate authority" so long as the seller meets various conditions designed to guard against "the exercise of market power" and "self-dealing." *Citizens Power*, 48 F.E.R.C. at ¶ 61,777. A seller's application for market-based rate authority is subject to public review and comment, and aggrieved parties may seek judicial review of the Commission's determination of market power (or lack thereof). FERC requires sellers to file updates upon any change in information relevant to the competitiveness inquiry. The Commission retains broad authority to revoke a seller's market-based rate authorization if a seller fails to comply with these reporting requirements or if market conditions change. *See* 16 U.S.C. § 824e(a); *see, e.g., El Paso Elec. Co.*, 108 F.E.R.C. ¶ 61,071 (2004).[13]

The industry has relied on FERC's market-based rate framework in significantly increasing wholesale energy production. By 2000, the Commission had granted market-based rate authority to nearly 900 entities.[14] As the Commission has

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[13] For example, FERC revoked the market-based rate authority of various subsidiaries of Enron Corporation after finding that the entities engaged in market manipulation and failed properly to notify the Commission of increases in their market shares. *See, e.g., Enron Power Marketing, Inc. and Enron Energy Services, Inc.*, 103 F.E.R.C. ¶ 61,343 (2003); *El Paso Elec. Co.*, 108 F.E.R.C. ¶ 61,071 (2004).

[14] *See* Energy Information Admin., Office of Coal, Nuclear, Electric and Alternate Fuels, DOE, *The Changing Structure of the Electric Power Industry 2000: An Update* at 63 (Oct. 2000) ("*DOE Report*"), *available at* http://www.eia.doe.gov/cneaf/electricity/chg_stru_update/.

observed, these nontraditional sources of power have "increase[d] the efficiency of the trading process for sellers and buyers" and "give[n] clear price signals indicating the best place and time to build new generation."[15] They have also "increased capital available to market participants" and "improved the industry's ability to address credit issues, increased the ability of companies to buy and sell energy, and increased market liquidity."[16]

Since the foundation of the market-based approach to rate-setting depends on enforcement of contracts, the panel's displacement of *Mobile* and *Sierra* to require FERC to reexamine a contract it previously and properly upheld calls into question all market-based rate agreements. To be sure, the panel imposes its own approach to energy rate regulation. App. 57a ("market-based rate authority *may* be a tenable choice") (emphasis added). But even if it is possible for FERC to design a new regime that meets the criteria outlined by the panel, the Ninth Circuit's holding providing for reconsideration of contract terms after-the-fact has upended the settled expectations of vast numbers of energy market participants.

Of course, purchasers who entered into valid contracts that they would now like to undo are eager to take advantage of the decision below. Fewer than three months after the Ninth Circuit's decision, the Illinois Attorney General filed a Section

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[15] *DOE Report* at 63.

[16] Office of Market Oversight & Investigations, FERC, *2004 State of the Markets Report* at 64 (June 2005), *available at* http://www.ferc.gov/EventCalendar/Files/20050615093455-06-15-05-som2004.pdf.

206 complaint relying heavily on that decision.[17] There, Illinois utilities agreed to purchase wholesale power from fifteen suppliers, including petitioner Morgan Stanley. After sales commenced, the Illinois Attorney General complained to FERC that the price was too high and that FERC had never specifically approved these contracts. Prior to the decision below, both arguments were plainly foreclosed by *Mobile* and *Sierra*, cases which deem "improvident bargains" not a basis for undoing contracts and that do not turn on FERC's acceptance of the rate for filing. Predictably, the Illinois complaint relies on the decision below to question these core tenets of energy law. As the Illinois complaint portends, unless this Court reviews the decision below numerous complaints will be filed challenging valid wholesale energy contracts.

Finally, and most dangerously, if left undisturbed the panel decision will hamper the market response to the next period of energy price volatility. There is no doubt that the future will bring new periods of volatile energy prices. The power business always has had – and always will have – sudden price changes.[18] This is in part because power is hard to store, so inventory changes do not smooth out price changes.[19] Also, weather changes can have a dramatic effect on power prices, as weather can prompt sudden and unanticipated consumer demand for air conditioning or heat. And, since it can

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[17] *Complaint by the People of the State of Illinois, ex rel. Illinois Attorney General Lisa Madigan, Requesting that FERC Investigate Evidence of Price Manipulation in the Illinois Auction, Require Refunds for Sales at Rates that are Not Just and Reasonable, and Direct Certain Wholesale Electricity Suppliers to Show Cause Why Their Market-Based Rate Authority Should Not Be Revoked*, No. EL-07 (filed Mar. 15, 2007).

[18] *See* Daniel Gabaldon, et al., *Betting Big on Baseload*, Elec. J. (Aug. – Sept. 2006) (noting that gas prices "are extremely volatile and notoriously difficult to forecast" and also noting "staggering degree of uncertainty" in electric industry).

[19] *See Key Facts, supra.*

take years to build a power plant, planning must be done far in advance despite the fact that future demand and supply conditions are hard to predict.

During the inevitable times of high energy price volatility, sensible regulatory policies *encourage* long term contracts in the energy market. Until the decision below, the standard solution for companies wishing to make long term plans in the volatile energy market was to enter into long term contracts with those, like petitioner, willing to bear the risk of future price changes. As FERC found, the contract at issue allowed Snohomish to protect itself against spot market fluctuations. The Ninth Circuit's decision that market conditions will form the basis of a relaxation of the bedrock principle of contract integrity will deter sellers from entering into long term contracts that provide similar benefits in the next period of energy price volatility, as sellers will know that their contracts can be undone after they have lost millions in the short term. If, for example, Morgan Stanley had declined to enter into any agreement with Snohomish – as would have been the case had it known that the contract could be undone by Snohomish despite its explicit agreement to the contrary – then Snohomish (and other utilities) would have been much worse off. The decision below discourages market solutions to price volatility.

At bottom, the Ninth Circuit ignores the dynamic nature of markets and focuses on short term, minor benefits to current consumers, with no acknowledgement of the harm that its decision will cause to those same consumers and other market participants in the long run. In directing FERC to reconsider whether to void this contract, the panel may have intended to assure that consumers receive some recompense for the serious problems caused by the spot market energy crisis. But, no matter the intention, the predictable effect of this ruling is increased harm to consumers as the benefits of the market and sophisticated agency regulation are replaced by the after-the-fact judgments of an appellate panel.

Indeed, the ironic effect of the panel's decision will be an increased reliance on spot market energy sales, the very evil that helped cause the energy crisis in the first instance. If FERC – and reviewing appellate courts – have authority as broad as that invoked below to undo long term contracts, the industry will increasingly rely on contracts of short duration because market conditions are less likely to change in the short term. Yet, it was precisely an over-reliance on spot market agreements that, FERC concluded, helped cause the California energy crisis in the first instance.[20]

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By undermining long term contracts in an industry uniquely dependent on them, the decision below is already causing significant harm to the energy markets. Review by this Court is thus urgently needed to remove the unsettling cloud the Ninth Circuit's decision has placed on industry expectations that the conditions of long term contracts will generally be honored. For this reason, as well as the necessity of correcting the Ninth Circuit's disregard for this Court's *Mobile* and *Sierra* decisions, review of the case is clearly warranted.

CONCLUSION

For the foregoing reasons, the petition should be granted.

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[20] *San Diego Gas & Elec. Co.*, 93 F.E.R.C. ¶ 61,121 (2000).

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